

Board of Investments:

Article VIII, Section 13 of the Montana Constitution created the Unified Investment Program, which includes all state agency funds. The Board, by law, invests the Unified Investment Program. Local governments may also invest with Board. The Board manages seven investment pools, which operate like mutual funds.

1. Retirement Funds Bond Pool
2. Trust Funds Bond Pool
3. Short Term Investment Pool
4. Montana Domestic Stock Pool
5. Montana International Equity Pool
6. Montana Private Equity Pool
7. Montana Real Estate Pool

Annual audited financial statements are prepared for each investment pool. Investments not managed in pools are included in an "all other funds" financial statement. The In-State Investment Program consists of Montana residential mortgages purchased by the states two large pension funds and commercial loans funded by the Coal Tax Trust. The Board also issues tax-exempt bonds and lends the proceeds to eligible government agencies for a variety of purposes.

In addition to the Board's investment responsibilities, it is charged with creating solutions to financial issues facing new and expanding businesses in the state of Montana. To accomplish this goal, the Board administers a number of different loan programs that can be specifically tailored to meet an individual business's or local government's needs.

The Board of Investments is funded with both enterprise and internal service type proprietary funds, and no direct appropriations are provided in HB 2.

Board of Investment responsibilities are mandated primarily in Article VIII, Section 13 of the Montana Constitution, Title 2, Chapter 15, and Title 17, Chapters 5 and 6, MCA.

Mission:

To provide prudent investment management of state and local government funds; work with financial institutions, state agencies, and local governments to enhance and expand Montana's economy and assist new and expanding Montana businesses; and to lend low-interest funds to eligible governments for a variety of projects.

To meet these challenges, the Board of Investments is committed to employing proven, long-term investment strategies and finding creative solutions to financial issues facing government entities and new and expanding businesses in the state.

Board of Investments HB 576 Program Description:

Unified Investment Program:

The Board of Investments manages the Unified Investment Program mandated by Article VIII, Section 13 of the Montana Constitution. Section 17-6-201, created the Board of Investments, and gave the Board sole authority to invest state funds. The Board also invests local government funds at their discretion. The Board currently manages an investment portfolio with a market

value of approximately \$11.2 billion. The Board manages the portfolio under the "prudent expert principle."

To provide for diversification and reduced risk, the Board manages several investment pools in which funds of similar types are invested. The Legislative Auditor audits the Board annually. The Board consists of nine members appointed by the Governor.

In-State Investments:

Section 17-6-305, MCA authorizes the Board to invest up to 25 percent of the Permanent Coal Tax Trust Fund to assist Montana's economic development. This "In-State Investment Program" makes business loans from the Trust in participation with financial institutions. The Board lends Trust Fund monies to local governments to fund infrastructure that will serve job-creating businesses locating in the government's jurisdiction. The Board also lends low-interest monies funded from the Trust to value-added type businesses creating jobs. Throughout Fiscal 2006, the Board purchased Montana residential mortgages with pension funds as part of the In-State Investment Program.

INTERCAP Program:

The Board sells tax-exempt bonds and lends the proceeds to eligible governments for a variety of projects. Loan terms range from one to ten years, and short-term loans to finance cash flow deficits or bridge financing are also available. The INTERCAP and In-State Investment Programs were created in fiscal year 1984 as part of the "Build Montana" program.

The Board of Investments is funded by two proprietary fund types. Accounting entity 06014, an enterprise fund, funds the Intercap or Bond Programs. Accounting entity 06527, an internal service fund, funds the Investment Programs.

Board of Investment responsibilities are mandated primarily in Article VIII, Section 13 of the Montana Constitution, Title 2, Chapter 15, and Title 17, Chapters 5 and 6, MCA.

Board of Investments customers include: state agencies, the university system, local governments, financial institutions, and local economic development organizations.

There has been no significant change in the services provided by the Board of Investments from those provided in the last biennium, although the investment portfolio continues to grow in size and complexity.

HB 576 Revenues, Expenses, and Fund Equity:

Revenue Description:

Nearly all Bond Program revenues (accounting entity 06014, an enterprise fund) are generated by the difference between interest rates on bonds sold and the interest rate charged on loans to borrowers. Since these revenues are only received from the trustee on an annual basis, a 270 day fund balance is required to provide adequate funding for the Bond Program between draws. Remaining revenues are received monthly from the Board's contract with the Montana Facility Finance Authority.

Nearly all Investment Program revenues (accounting entity 06527, an internal service fund) are generated from charges to each account that the Board invests. The revenue objective of the Investment Program is to fairly assess the costs of operations while maintaining a reasonable and prudent 60 day working capital reserve.

The Board of Investments does not receive any direct appropriations.

FY 2006 base year funding, by fund type for the Investment Program, accounting entity 06527 is as follows:

	FY 2006	%
General Fund	\$ 77,974.76	2.418%
State Special	\$ 41,323.21	1.282%
Federal Special	\$ 2,497.57	0.077%
Proprietary	\$ 157,248.67	4.877%
Expendable Trust	\$ 79,154.10	2.455%
Non Expendable Trust	\$ 2,776,507.71	86.107%
Local Government	\$ 64,855.06	2.011%
University	\$ 21,976.06	0.682%
Debt Service	\$ 2,952.83	0.092%
Misc Reimbursement	\$ -	0.000%
Total:	\$ 3,224,489.97	100.000%

Customer expenditure codes are not available because many customers are outside of state government and therefore do not record their financial activity on SABHRS.

Bond Program revenues (accounting entity 06014) are primarily recorded in the following SABHRS revenue codes:

	FY 2006	%
525130	\$ 4,671.18	0.169%
527054	\$ 1,011.99	0.037%
530008	\$ 395,384.01	14.289%
530010	\$ 355,313.21	12.840%
530014	\$ (8,574.31)	-0.310%
530023	\$ (1,022.30)	-0.037%
530025	\$ 7,281.04	0.263%
530029	\$ (111,459.61)	-4.028%
538043	\$ 2,106,750.73	76.135%
538044	\$ 17,784.57	0.643%
Total:	\$ 2,767,140.51	100.000%

Investment Program revenues (accounting entity 06527) are primarily recorded in the following SABHRS revenue codes:

	FY 2006	%
521055	\$ 3,224,489.97	100.000%

Expense Description:

The major cost drivers within the Board of Investments are personal services, operating expenses and expenditures related to the periodic replacement of computer equipment. Additionally, over

\$3.068 million was disbursed from accounting entity 06014 in FY 2006 via a statutory appropriation for debt service requirements related to the state's bonding activity.

FY 2006 base year expenditures, for accounting entity 06014 are as follows:

	FY 2006	%
FTE	4.00	
Personal Services	\$ 249,636.53	7.256%
Operating Expenses	\$ 121,926.83	3.544%
Debt Service	\$ 3,068,931.82	89.200%
Total:	\$ 3,440,495.18	100.000%

FY 2006 base year expenditures, for accounting entity 06527 are as follows:

	FY 2006	%
FTE	30.00	
Personal Services	\$ 1,884,259.40	54.018%
Operating Expenses	\$ 1,603,958.56	45.982%
Total:	\$ 3,488,217.96	100.000%

Please note that accounting entity 06527 also pays for 1.00 FTE in the Treasurers' Office in the Department of Administration through a direct appropriation in HB 2.

There is little uncertainty in forecasting major cost drivers and for the purposes of this analysis it is assumed the Division's workload and customer levels will remain constant, although investment portfolios will continue to grow in size.

Non-typical and one time only expenses, if any, are subtracted from proposed budgets. The Board of Investments is authorized 34.00 FTE (approximately 30.00 funded from accounting entity 06527, and 4.00 funded from accounting entity 06014) and personal services expenditures include Board Member Per Diem.

Working Capital Discussion:

Revenues for accounting entity 06014 are typically received on an annual basis, so a 270 day fund balance is required to provide adequate funding for the Bond Program between draws.

Revenues for accounting entity 06527 are assessed on a monthly basis; since collections lag by at least one month the Board must maintain a nominal 60 day working capital reserve to meet ongoing operational expenses.

Fund Equity and Reserved Fund Balance:

At the proposed rates, the Department projects a fiscal year end 2009 ending working capital reserve of approximately 60 days for accounting entity 06527. All interest earnings on the working capital reserve are distributed to the state general fund.

Rate Explanation:

The Board of Investments recovers its costs from the entities that use its services. Typically, this has been done by requesting a maximum level of expenditures similar to what occurs in HB 2 and setting the fee at that level. This process has worked very well since the passage of HB 576 and this methodology is continued in the 2009 biennium because it provides an easy comparison with historical financial activity.

Significant Present Law:

The Board of Investments accounting entity 06527 has two decision packages which effect portfolio assessments.

Investment Research and Investment Tools:

Given the large amount of funds managed by the Board (\$11.2 billion) and the spotlight on the Board's investment performance relative to the serious "unfunded pension liabilities" the Board requires the tools and resources necessary to effectively manage the portfolio. These are present law adjustments based on the Board's governing "prudent expert" statute that requires it to minimize risk and maximize return. These resources will assist the Board in fulfilling the law's expectation.

General Investment Consultant: For the first time since the Board was created in 1972, it has hired a general investment consultant to assist in asset allocation, conduct pension fund asset/liability studies, and assist in the selection and monitoring of external investment managers. R.V. Kuhns & Associates was hired in December, 2005 under a 4-year contract at \$250,000 annually. The additional cost above the base to annualize this contract is \$105,000 per year.

Specialist Real Estate Consultant: Based on the findings in the recently-completed asset/liability study of the Teachers' Retirement System and to further diversify pension fund portfolios, the Board created a new real estate pool and is currently searching for real estate managers. R.V. Kuhns will provide the consulting for "core" real estate managers (this is the simplest and lowest risk of all real estate investments that generally consists of low vacancy, high quality properties). Funds managed by core managers are generally open-ended and will accept new clients on a consistent basis. R.V. Kuhns maintains a data base of all core real estate managers which breaks down portfolios by region and real estate type. The firm also tracks performance and portfolio risk.

A consultant specializing in real estate is required to search for and assist in finding quality "value-added" and "opportunistic" real estate managers (these investments are higher risk but also provide higher returns and generally have limited windows of opportunity to accept new clients). The Board hired Courtland Real Estate Advisors in June to assist in these specialized real estate assets. Courtland maintains a data base of all value-added and opportunistic managers, tracks their risk and performance, and also notifies the Board when windows of opportunity to invest are scheduled. The approximate annualized cost for this contract is \$150,000 per year.

Bloomberg Financial Network: Board staff utilizes the Bloomberg Financial System to provide security research and portfolio order management. We have recently been noticed by Bloomberg of price increases to be phased in over the next year. During the next biennium those cost increases will be approximately \$75,000 per year above the FY 2006 base.

Annualized Research Costs: During the past year, the Board has transferred the cost of several research resources from “soft dollars” to “hard dollars”, which derive from the Board’s budget. Additional research resources were obtained in FY 2006 at the request of the Board’s new Chief Investment Officer who was hired in October 2005. The cost per year to annualize the research resources currently utilized by staff is \$60,000.

The total cost of this decision package is \$390,000 in FY 2008 and FY 2009 and is funded from accounting entity 06527. It is estimated that this decision package would impact assessments as follows:

	FY 2008	FY 2009
Requested Fee Assessment	\$ 4,664,072	\$ 4,664,072
Decision Package Amount	\$ 390,000	\$ 390,000
Variance:	\$ 4,274,072	\$ 4,274,072

Administrative Costs Adjustments:

The total cost of this decision package is \$225,822 in FY 2008 and \$83,968 in FY 2009 and is funded from accounting entity 06527. Items requested include adjustments for overtime, Per Diem, rent adjustments, and indirect cost adjustments. The proposal would also provide for asset/liability studies of seven smaller pension funds at an estimated cost of \$140,000 in FY 2008 only ($\$20,000 \times 7 = \$140,000$). It is estimated that this decision package would impact assessments as follows:

	FY 2008	FY 2009
Requested Fee Assessment	\$ 4,664,072	\$ 4,664,072
Decision Package Amount	\$ 225,822	\$ 83,968
Variance:	\$ 4,438,250	\$ 4,580,104

New Proposals:

There are no new proposals for accounting entity 06527.